No. 158

In the Supreme Court of the United States

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THOMAS B. LILLY AND HELEN W. LILLY,
PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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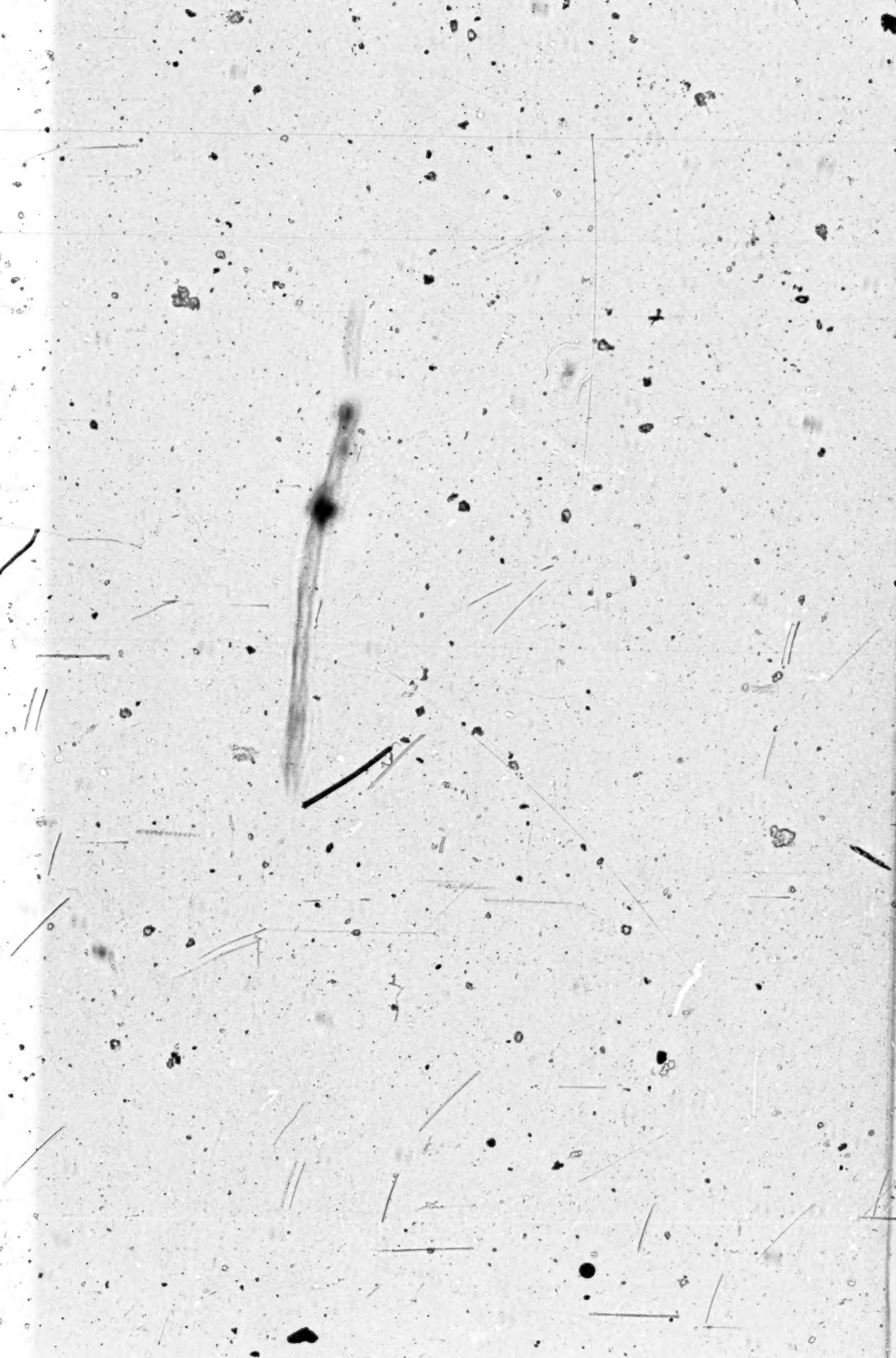

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OPINIONS BELOW

The opinion of the Tax Court rendered *en banc* (R. 176-196), Judge Arundell dissenting (R. 196-199), is reported in 14 T. C. 1066. The opinion of the Court of Appeals (R. 224-229) is reported in 188 F. 2d 269.

JURISDICTION

The judgment of the Court of Appeals was entered on April 2, 1951. (R. 229-230.) The petition for a writ of certiorari was filed on June 29,

1951. The jurisdiction of this Court is invoked under the provisions of 28 U.S.C., Section 1254.

QUESTION PRESENTED

Taxpayers, who were engaged in the business of grinding, fitting and selling eye glasses, entered into oral contracts or understandings with various physicians, whereby taxpayers agreed to pay the physicians one-third of the retail price of all glasses purchased by patients guided to them by these physicians. In practically every instance the patient was unaware of the "kickback" paid to his doctor.

The question presented is whether the Tax Court and the court below erred in holding that these secret commissions or rebates paid to the doctors were not deductible by taxpayers under Section 23(a)(1)(A) of the Internal Revenue Code as "ordinary and necessary" business expenses.

STATUTE AND REGULATIONS INVOLVED

Internal Revenue Code:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(a) [As amended by Sec. 121 (*a*) of the Revenue Act of 1942, c. 619, 56 Stat. 798.] *Expenses.*

(1) *Trade or Business Expenses.*—

(A) *In general.*—All the ordinary and necessary expenses paid or incurred dur-

> ing the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; * * *.

(26 U.S.C. 1946 ed., Sec. 23.)

Treasury Regulations 111, promulgated under the Internal Revenue Code:

> SEC. 29.23 (a)-1. *Business Expenses.*—Business expenses deductible from gross income include the ordinary and necessary expenditures directly connected with or pertaining to the taxpayer's trade or business, except the classes of items which are deductible under section 23 (b) to 23 (z), inclusive, and the regulations thereunder. Double deductions are not permitted. Amounts deducted under one provision of the Internal Revenue Code cannot again be deducted under any other provision thereof. * * *

STATEMENT

The Tax Court and the Court of Appeals found the facts as follows with respect to the single issue [1] raised on appeal:

Taxpayers are husband and wife, and were during the taxable years 1943 and 1944 engaged in the optical business under the trade name of City Optical Company in Wilmington, North Carolina, with

[1] Four other issues were decided by the Tax Court in taxpayers' favor. (14 T. C. 1066-1067.) The Commissioner did not appeal from these adverse rulings.

branches in other North Carolina localities, and under the name of Richmond Optical Company in Richmond, Virginia. (R. 176-177.) Taxpayer Helen W. Lilly also conducted a similar business under the name of Duke Optical Company in Fayetteville, North Carolina. (R. 176-177, 224-225.)

The City Optical Company, in computing its net income, deducted the sum of payments in each year made to various physicians specializing in the care and treatment of the eye. These payments were described upon its books as "trade discounts". The basis for these payments was an agreement or understanding between such physicians and the City Optical Company that each physician, after performing service for his patient and prescribing proper lenses would, if possible, guide the patient to this particular optical company for the work of grinding the glasses and furnishing and fitting frames. Under these agreements the City Optical Company paid to the physician in each case one-third of the amount it charged his patient for the services performed by the optical company. No information was volunteered to the patient that payment was to be made by the optical company to the physician of any portion of the amount paid by him to the optical company for the service there rendered. If a patient asked whether any portion of his payment to the optical company would be paid over to the physician, he was told; but this

occurred very rarely. (R. 177-178, 181, 191-193, 225.)

The label "trade discounts", under which taxpayers recorded these payments in their books did not correctly describe them (R. 193), but camouflaged them (R. 229). The payments to some of the oculists were made in cash at their request. (R. 193.) So far as disclosed by the record, the contracts between taxpayers and the doctors were oral. (R. 192-193.)

Patients were usually told by the physician that when their glasses were made and fitted by the optical company to bring them back to the physician for him to check the quality and accuracy of the work done by the optical company and to see if they had been properly fitted. The work to be done by the physician on return to him by the patient might include a re-examination of the eyes of the patient, if such was required. All of these services to be rendered later by the physician were included in the charge made the patient by the physician and, accordingly, no additional charge was made for this service, whether the patient had the prescription filled by an optical company with which the physician had a so-called "kickback" agreement or an optical company with which the physician had no such agreement. (R. 178, 182-183.)

The patient in practically every instance was unaware of the fact that his physician was receiv-

ing from the optical company a portion of his payment made to that comapny. (R. 178.)

The same agreement as to "trade discounts" was made and carried out under similar circumstances by taxpayer Helen W. Lilly, trading as Duke Optical Company, for 1943 and 1944. (R. 179, 225.)

Explanations by various witnesses at the hearing, as tending to justify the propriety of the arrangement between taxpayers and the physicians, were found by the Tax Court not to be convincing. (R. 182.)

No basis was found for the statement by some witnesses that the optician was considered as an agent or employee of the physician. The particular optician was selected by the patient, who was free to make any selection. (R. 182.)

In some cases oculist-physicians did their own "dispensing", that is, they not only measured vision and prescribed the lenses, but sent the prescription to some optical company for the grinding and fitting of the lenses to the type of frame selected by the patient, the measurements for which had been taken by the physician. On the return to the physician of the fitted lenses, they were adjusted by the physician to the patient and a total charge was made for the entire service. In these cases the practice was for the physician to charge his patient the fee for the service rendered and the retail price for the lenses and frames furnished by the optical company. The physician was then

billed by and paid the optical company at the lower wholesale rate for the lenses and frames. (R. 179, 183.)

The Tax Court found to be without basis in fact the explanation by some witnesses that the surrender by the physician of the profit he thus would have made (if he had personally bought the lenses and frames and fitted the glasses) constituted consideration for and entitled him to receive a portion of the profit derived by the optician for that service. The employment by the patient of an optician to perform the service in question relieves the physician not only of the work of the fitting and adjusting glasses, but also of the burden of financing their manufacture and eliminates the possibility of loss to the physician through the patient's failing to pay for the glasses. (R. 183.)

Taxpayers did not contend, nor did any witness testify, that the aggregate fees of the oculist and the optician or even the cost of glasses to a patient was less or no more under the "kickback" arrangement than it would have been in its absence. The practice tended to increase that cost. The oculist knew of his contract with the optician, when each patient was examined. The patient, in practically all cases, knew nothing of the arrangement. The oculist, in a relationship of great trust and confidence with respect to the patient, was subjected to the temptation of prescribing glasses where not actually necessary, or more expensive lenses than

those really needed, and of recommending an inferior optician. The cost of glasses was artificially increased by the inclusion of the physician's commission, for which the physician afforded no consideration to the patient. (R. 191, 228.)

One of the two optical companies in Greensboro, North Carolina, a competitor of the City Optical Company, ceased its practice of paying these commissions or "kickbacks" to oculists subsequent to the taxable years and prior to the hearings of the instant proceedings. (R. 178-179, 193.)

No witness, who was asked, knew of any canon of ethics of the various medical societies or associations specifically forbidding this particular practice of oculists' accepting so-called "kickbacks" from optical companies, but the practice was frowned upon and considered unethical by the medical profession as a whole, and had been criticized and condemned at meetings of the medical associations and in their professional publications. (R. 178, 185.) The Medical Society of North Carolina—the state in which these taxpayers were chiefly engaged in business—had condemned the practice. (R. 178, 228-229.)

The Principles of Medical Ethics of the American Medical Association (1943), Chapter III, Article 1, Section 5, contains the following (R. 228):

> It is unprofessional to accept rebates on prescriptions or appliances, or perquisites from attendants who aid in the care of patients.

And in Chapter III, Article VI, Section 4 (R. 228):

> When a patient is referred by one physician to another for consultation or for treatment, whether the physician in charge accompanies the patient or not, it is unethical to give or to receive a commission by whatever term it may be called or under any guise or pretext whatsoever.

The several state medical associations have by their canons of ethics condemned the "splitting of fees" between physicians. (R. 179.)

At least two states (California and Washington) have enacted legislation forbidding this rebate practice. (R. 228.)

"Trade discounts" allowed oculist physicians by the City Optical Company for the three following years were (R. 179):

1942—	$57,063.45[2]
1943—	61,601.95
1944—	60,021.65

"Trade discounts" allowed oculist physicians by Duke Optical Company for 1943 were $6,568.87, and for 1944 were $4,798.35. (R. 179.)

In determining deficiencies against taxpayers, the Commissioner disallowed these trade discounts

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[2] Income for 1942 is relevant by reason of its effect on computation of the 1943 tax under the forgiveness features of the Current Tax Payment Act of 1943, c. 120, 57 Stat. 126, Sec. 6.

as deductions (R. 1), and upon redetermination, in an opinion rendered *en banc*, the Tax Court sustained the Commissioner (R. 180-196), Judge Arundell dissenting (R. 196-199). Accordingly, the Tax Court decided [3] that there were deficiencies in income taxes due from taxpayer Thomas B. Lilly for the years 1943 and 1944 in the amounts of $54,953.67 and $19,301.68, respectively (R. 199-200), and in the case of taxpayer Helen W. Lilly for the years 1943 and 1944 in the amounts of $26,685.29 and $23,167.14, respectively (R. 200).

Upon taxpayers' appeal, the court below unanimously affirmed the decision of the Tax Court (R. 224-229), holding that (R. 227):

> We certainly will not lend the force of any opinion of this court to sanction, as an "ordinary and necessary" expense of the optician's business, the making and carrying out of such unconscionable and reprehensible contracts for secret kickbacks to a doctor.

ARGUMENT

The decision of both the court below and the Tax Court, that these secret "kickbacks" to doctors are not an "ordinary and necessary" expense of an optician's business is correct and presents no question warranting further review by this Court. The ruling below is based upon the settled construction of the words "ordinary and necessary", as em-

[3] Certain uncontested amounts, not here in issue, appear also to be included in the deficiencies, as found by the Tax Court. (14 T.C. 1067.)

ployed by Congress in the governing statute authorizing deduction of trade or business expense. Internal Revenue Code, Section 23 (a)(1)(A), *supra*, pp. 2-3. Moreover, there is no conflict of decisions requiring resolution by this Court.

1. A taxpayer seeking a deduction must be able to show that he comes within the terms of an applicable statute. *New Colonial Co.* v. *Helvering*, 292 U.S. 435, 440. The courts have frequently ruled that the allowance of a deduction is a matter of legislative grace and not a matter of right, and depends upon establishment of clear legislative provision therefor. *Deputy* v. *duPont*, 308 U. S. 488, 493; *White* v. *United States*, 305 U. S. 281, 292; *City Ice Delivery Co.* v. *United States*, 176 F. 2d 341, 350 (C. A. 4th). As a corollary, taxpayers' burden in the Tax Court was not merely to overcome the presumptive correctness of the Commissioner's determination, but further to sustain the burden of persuasion, to establish the facts and their right to the alleged deduction. *Welch* v. *Helvering*, 290 U. S. 111, 115; *Helvering* v. *Taylor*, 293 U. S. 507, 514-515; *Boehm* v. *Commissioner*, 326 U. S. 287, 294, rehearing denied, 326 U. S. 811.

Both the Treasury and the courts have in innumerable instances been called upon to define and apply the statutory words "ordinary and necessary" to a particular state of facts. *Welch* v. *Helvering*, *supra*, p. 116; *Deputy* v. *duPont*, *supra*, p.

496; *Textile Mills Corp.* v. *Commissioner*, 314 U. S. 326, 338. Ordinarily, this Court does "not enter this quagmire of particularities." *McDonald* v. *Commissioner*, 323 U. S. 57, 65; *Commissioner* v. *Heininger*, 320 U. S. 467, 475. The rule has been evolved that no deduction should be allowed as "ordinary and necessary" which frustrates defined national or state policies proscribing particular types of conduct (*Commissioner* v. *Heininger*, *supra*, p. 473); "in the nature of things, public policy must narrow the field of allowable deductions which rest as they do upon legislative indulgence." *National Brass Works* v. *Commissioner*, 182 F. 2d 526, 530 (C. A. 9).

The Treasury, the Tax Court, and the federal courts have repeatedly drawn a line between legitimate business expenses and those incident to contracts or practices which contravene public policy. *Textile Mills Corp.* v. *Commissioner*, *supra*, pp. 338-339; *Commissioner* v. *Heininger*, *supra*, pp. 473-474; *Rugel* v. *Commissioner*, 127 F. 2d 393, 395 (C. A. 8th); *Harden M. Loan Co.* v. *Commissioner*, 137 F. 2d 282, 284 (C. A. 10th); *Cohen* v. *Commissioner*, 176 F. 2d 394, 400-401 (C. A. 10th); *Wagner* v. *Commissioner*, 30 B.T.A. 1099; *Keiley-Dempsey & Co.* v. *Commissioner*, 31 B.T.A. 351; *Anderson* v. *Commissioner*, 35 B.T.A. 10; *Easton Tractor & Equipment Co.* v. *Commissioner*, 35 B.T.A. 189; *Kyne* v. *Commissioner*, 35 B.T.A. 202; *Nicholson* v. *Commissioner*, 38 B.T.A 190, 198-199;

Maddas v. *Commissioner*, 40 B.T.A. 572, 581-582, affirmed on another ground, 114 F. 2d 548 (C. A. 3d); *Silberman* v. *Commissioner*, 44 B.T.A. 600; *Weather-Seal Mfg. Co.* v. *Commissioner*, 16 T. C. No. 158; *Giubbini* v. *Commissioner*, decided October 27, 1939 (1939 P-H B.T.A. Memorandum Decisions, par. 39,471); *Barlow* v. *Commissioner*, decided May 19, 1943 (1943 P-H B.T.A. Memorandum Decisions, par. 43,237).

On the same principle, fines and penalties paid to the national or state governments are not comprehended within the meaning of "ordinary and necessary" business expenses since their allowance would, by way of a tax advantage, constitute a partial remission, thus circumventing the public policy pursuant to which the sanctions are imposed. *Great Northern Ry. Co.* v. *Commissioner*, 40 F. 2d 372 (C.A. 8th); certiorari denied, 282 U. S. 855; *Burroughs Bldg. Material Co.* v. *Commissioner*, 47 F. 2d 178 (C. A. 2d); *Chi. R. I. & P. Ry. Co.* v. *Commissioner*, 47 F. 2d 990, 991 (C. A. 7th), certiorari denied, 284 U. S. 618; *Tunnel R. R.* v. *Commissioner*, 61 F. 2d 166, 173-174 (C. A. 8th), certiorari denied, 288 U. S. 604; *National Outdoor Advertising Bureau* v. *Helvering*, 89 F. 2d 878, 881 (C. A. 2d); *Standard Oil Co.* v. *Commissioner*, 129 F. 2d 363 (C. A. 7th); *Helvering* v. *Superior Wines & Liquors*, 134 F. 2d 373 (C.A. 8th), certiorari denied, 317 U. S. 688; *Commissioner* v. *Longhorn Portland Cem. Co.*, 148

F. 2d 276 (C. A. 5th), certiorari denied, 326 U. S. 728; *Universal Atlas Cement Co.* v. *Commissioner*, 171 F. 2d 294 (C.A. 2d), certiorari denied, 336 U. S. 962; *Jerry Rossman Corp.* v. *Commissioner*, 175 F. 2d 711, 713 (C. A. 2d); *National Brass Works* v. *Commissioner*, 182 F. 2d 526 (C. A. 9th), on remand to Tax Court, 16 T. C. No. 130; *Scioto Provision Co.* v. *Commissioner*, 9 T. C. 439; *Garibaldi & Cuneo* v. *Commissioner*, 9 T. C. 446; *Henry Watterson Hotel Co.* v. *Commissioner* 15 T. C. 902, pending on appeal (C. A. 6th).

2. That these payments were opposed to public policy was the conclusion of the Tax Court *en banc* (R. 196) (only one judge out of sixteen dissenting), and the unanimous judgment of the Court of Appeals (R. 228). Such a judgment this Court will not reverse "without a definite conviction of error in the conclusion" (*Helvering* v. *Stuart*, 317 U. S. 154, 163), and, indeed, this Court avoids (p. 164) "becoming a Court of first instance for the determination of the varied rules of local law prevailing in the forty-eight states."

The Court of Appeals held that "the making and carrying out of such unconscionable and reprehensible contracts for secret kickbacks to a doctor * * * corrupt the fiduciary relationship between physicians and patient and result in a violation of the duty of loyalty" (R. 227-228). Taxpayers' assertions that such secret kickbacks were normal and appropriate in the optician's trade are totally

without support in any finding by the Tax Court or the court below, and seem to be based only on statements, often self-serving, of various witnesses. (Pet. 3-4.) The Tax Court and the court below held, however, that this "kick-back" practice was corrupt (R. 191, 228) and neither ordinary nor necessary. For example, the Tax Court found that a competitor of taxpayers, one of the two optical companies in Greensboro, North Carolina, had ceased the practice prior to the instant hearings. (R. 178-179, 193.) The Medical Society of North Carolina—the state in which taxpayers were chiefly engaged in business—had condemned it (R. 178, 228-229); it was considered unethical by the medical profession as a whole, and criticized at meetings of medical associations and in professional publications (R. 178, 185). The American Medical Association, in its Principles of Medical Ethics, quoted in the Statement, *supra*, pp. 8-9, condemns such a rebate practice (R. 228), and by resolutions and other pronouncements published in its official journal has consistently denounced this "barter and trade in the sick patient" and "these unwholesome profits in this marketing of medical care."[4] (Appendix, *infra*, pp. 24, 25.)

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[4] Editorial, dated January 17, 1948, signed by the Association's officers and board of trustees, 136 Journal of the American Medical Association, 176-177, for convenience reprinted in Appendix, *infra*, pp. 24-28. See also editorial, dated August 3, 1946, 131 *id.* 1128, likewise reprinted in Appendix, *infra*, pp. 21-24. These editorials refer an anti-trust suit brought by the United States in the Northern Dis-

Again, petitioners' statement (Pet. 3) that "This arrangement did not increase the price which the patient would otherwise pay for the glasses" is controverted by the express Tax Court finding that (R. 191) "It is clear to us that the practice tended to increase that cost", a finding expressly upheld by the Court of Appeals (R. 228).

In at least two states, the practice has been regarded as so objectionable, both as to payer and recipient of such rebates, as to deserve criminal penalty, Remington's Revised Statutes of Washington, Annotated (1949 Supp.), Section 10185-14; California Business and Professions Code (Deering, 1949 Pocket Supp.), Sections 650, 652. While not technically commercial bribery (1 General Statutes of North Carolina (1943), Section 14-353; Virginia Code of 1942, Annotated, Section 4712), or commercial extortion,[5] these secret kickbacks fall within the proscription of the same general public policy, sharply defined by a long line of judicial decisions, which forbids corruption of a fiduciary relationship by payment of a secret consideration. *Mosser* v. *Darrow*, 341 U. S. 267,

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trict of Illinois against a wholesale optical company and a number of physicians, to enjoin secret rebate arrangements similar to those involved here (R. 202-221). On May 16, 1951, subsequent to the decision below, a consent decree was entered providing substantially the relief requested in the complaint.

[5] See *Kelley-Dempsey & Co.* v. *Commissioner*, 31 B.T.A. 351, *supra*, cited by this Court in *Commissioner* v. *Heininger*, 320 U. S. 467, 474, fn. 10, *supra*.

271; *Wolf* v. *International Reinsurance Corp.*, 73 F. 2d 267 (C. 2d), certiorari denied, 294 U. S. 725; *Reilly* v. *Beekman*, 24 F. 2d 791 (C. A. 2d); *City of Findlay* v. *Pertz*, 66 Fed. 427, 434 (C. A. 6th); *Meinhard* v. *Salmon*, 249 N.Y. 458, 464; 6 Williston on Contracts (Rev. ed.), Section 1737, pp. 4905, 4906-4907, fn. 10; 2 Restatement, Contracts, Section 570.

Nor does the decision below involve unfair "retroactive" action. (Pet. 17.) As the court below pointed out, the record fails to disclose that the Commissioner had been definitely apprised of this practice, and in view of the camouflage of the payments as "trade discounts", there was little to put him on notice that the claimed deductions were secret kickbacks. (R. 193, 229.) Nor can the Treasury be expected, by express regulation, to cover every form of commercial practice. (R. 229.)

In summary, in the light of the careful consideration which the special facts of the instant record have already received in the Tax Court and the Court of Appeals, the statement by this Court in the *Heininger* case here assumes particular relevance (320 U. S. 467, 473):

> A review of the situations which have been held to belong in this category would serve no useful purpose for each case should depend upon its peculiar circumstances.

3. The decision below is not in conflict with any decision of this Court or of other Courts of Ap-

peals. Contrary to taxpayers' contention (Pet. 8-11), *Commissioner* v. *Heininger* supports the decision below (320 U.S. 467, 473-474), for to permit the deduction here, as the Tax Court noted (R. 180-181), would directly frustrate the public policy proscribing corruption of the fiduciary relationship between physician and patient and forbidding violation of the duty of loyalty. Taxpayers' acts in making the reprehensible agreements and their "greasing of palms" (R. 194) immediately effected the corruption; they are among the acts which the public policy *per se* prohibits. To allow such unconscionable secret "payoffs", under the guise of ordinary and necessary business expenses, would directly encourage the tendency to corrupt and defeat the public policy. Compare *Textile Mills Corp.* v. *Commissioner*, 314 U. S. 326, 339, *supra*.

Similarly, contrary to taxpayers' contention (Pet. 11), the decision below does not conflict with *Jerry Rossman Corp.* v. *Commissioner*, 175 F. 2d 711 (C. A. 2d), *supra*, since the present taxpayers' violation of public policy was not innocent but intentional, and allowance of the deduction would directly frustrate such policy. Taxpayers entered into the objectionable agreements and made the payments to the physicians, as the Tax Court found, because they knew that the high degree of trust and confidence existing between the doctors

and their patients would result in the patients' following the doctors' recommendation of an optician, as they did. (R. 192, 196.)

The purpose of the settled rule applied below is not punitive, contrary to taxpayers' argument (Pet. 11), but defensive, lest the Congressional favor of a tax deduction be misconstrued or misused to the public harm. Clearly, no such considerations apply to civil damages paid individuals in reparation of tortious conduct; hence, cases such as *Anderson* v. *Commissioner*, 81 F. 2d 457 (C. A. 10th), and *Helvering* v. *Hampton*, 79 F. 2d 358 (C. A. 9th), cited by taxpayers (Pet. 12), are not opposed to the decision below. There is a sharp difference between payments which are against public policy and those which constitute restitution for damages caused by prior tortious conduct. To permit the deduction of reparation payments, as ordinary and necessary business expenses, subverts no public interest, as would deduction of the rebates here.

CONCLUSION

The decision of the court below is correct, there is no conflict of decisions, and no question warranting review is presented. The petition for a writ of certiorari should be denied.

Respectfully submitted,

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AUGUST, 1951.

APPENDIX

EDITORIALS

131 Journal of the American Medical Association 1128 (August 3, 1946):

Indictment of Optical Firms and Ophthalmologists Under Sherman Act

Elsewhere in this issue (page 1138) appears a condensation of two complaints filed by the United States through the Department of Justice charging optical wholesalers and ophthalmologists with violating the Sherman Act by fixing prices on spectacles through rebating to the ophthalmologists approximately one half of the total price paid by their patients for eye-glasses. The Department of Justice adopted the unusual device of selecting certain physicians as representative of the entire class of physicians securing rebates as defendants in the suit. Attorney General Tom C. Clark said in connection with the filing of the suits that "the department is informed that the rebating practice is industry wide and it is presently expediting its investigation of all wholesale dispensers in the optical field. If investigation discloses similar practices, additional suits will be filed as quickly as possible." The newspaper release made by the Department of Justice states that some individual physicians receive as much as $40,000 annually in rebates. The actual figures cited in the complaint indicate instances in which a Chicago patient was charged $14 for lenses, the optician receiving $2.50 and the physician $11.50; an instance in which a patient paid $25 for lenses, the company receiving $10.80 and the physician $14.20. A Dallas patient

paid $21 for lenses, which was divided approximately equally between the optician and the physician, and an Oklahoma City patient paid $22, the manufacturer receiving $9.10 and the physician $12.90. Similar figures are available for prescriptions filed in Madison, Wis., Minneapolis and Denver. Moreover, the actual cumulative figures indicate that one group of physicians in Iowa received more than $42,000. One physician in a small town in Texas received almost $15,000, a sum equaled by physicians in Minneapolis, Waterloo, Iowa, Rockford, Ill., and other small communities.

The position of the American Medical Association on this practice has been stated definitely on several occasions. In 1924 the Section on Ophthalmology of the American Medical Association adopted a resolution stating:

> *Resolved,* That the acceptance of commissions or considerations, either directly or indirectly, from opticians and optical houses in the sale of glasses is absolutely contrary to all our standards of medical ethics and is just as reprehensible as the splitting of fees.

That resolution was not presented to the House of Delegates and was therefore an action of the section but not an action of the American Medical Association. In 1942 a resolution was presented to the House of Delegates to the effect that

> it be declared unethical for the members of the American Medical Association or its component branches to refer patients to commercial organizations, laboratories or other physicians who advertise to the public and

others than the medical profession who employ steerers or cappers or who offer to pay rebates or commissions or in any other manner violate the Principles of Medical Ethics of the American Medical Association or its component branches.

This resolution was referred to a reference committee, which brought back a revised resolution to the House of Delegates. The following revised resolution was adopted:

Resolutions on Rebates: Your reference committee has given very serious consideration to these resolutions. It is the opinion of your reference committee that the practices referred to in the resolutions are beneath the dignity of a learned profession, are basically dishonest and are a violation of the Principles of Medical Ethics. Your reference committee therefore recommends that the following substitute resolutions be adopted:

WHEREAS, It has been brought to the attention of the House of Delegates that the unscrupulous practice of rebates to physicians is being engaged in by various commercial organizations, laboratories, supply houses and in some professional relationships between certain physicians; and

WHEREAS, All such practices are clearly in violation of the Principles of Medical Ethics; therefore be it

Resolved, That the House of Delegates of the American Medical Association express stern disapproval of the practice by any of the

members of its component societies of referring patients to commercial organizations, laboratories or other physicians who advertise to the public and others than the medical profession, who employ so-called steerers or cappers or who pay, or offer to pay, rebates or commissions in any guise whatsoever, or who in any other manner violate the Principles of Medical Ethics of the American Medical Association; and be it further

Resolved, That any member violating these resolutions be subject to such disciplinary action as is deemed advisable by the county society in which such physician holds membership; and be it further

Resolved, That the Secretary of the American Medical Association be instructed to send a copy of these resolutions to each state and county society accompanied by a letter to the secretary of each setting forth that all such unethical practices are disreputable and unscrupulous and, if not controlled, may soon besmirch the reputation of the entire medical profession.

136 Journal of the American Medical Association 176-177 (January 17, 1948):

Rebates, Kickbacks, Commissions and Medical Ethics

The pride of medicine as a profession has always been its freedom from the taint of barter and trade in the sick patient. Physicians must give their wholehearted devotion to the care of the patient; no other objective must be given precedence over

considerations of the patient's need. Nevertheless, the charge is made that some physicians have forgotten the ethical principles that prevail in the relationship between doctor and patient and have selected the surgeon willing to make the greatest division of fees rather than the one best suited to perform the operation. Ophthalmologists have sent the patient for lenses to opticians who returned a proportion of the fee rather than to the optician who rendered the highest quality of optical service. Occasionally orthopedic surgeons and others who utilize the work of the maker of braces, splints and elastic bandages have been willing to accept commissions from such manufacturers and have designated the procurement of these accessories to the agency offering the largest commission rather than to the one most painstaking in production and most reasonable in price. From time to time criticism has been leveled against pharmacists who have offered commissions to physicians on the prescriptions sent to them and to the physicians who have accepted such commissions. Wherever barter and trade have insinuated their insidious and evil aspects into the practice of medicine, the quality of the service has depreciated. The morals of the physicians and the commercial agencies that deal in these unwholesome profits in this marketing of medical care have already deteriorated.

From the beginning of its entrance on the medical scene, the American Medical Association has fought this menace to the quality of medical service and to the good repute of medical practice. Resolutions have been passed by the official bodies

of the Association unequivocally condemning such practices. The Judicial Council has repeatedly urged the expulsion or other action against physicians proved to have participated in such procedures. The leaders of surgery, ophthalmology, orthopedic surgery and pharmacy have been unanimous in pointing out the extent to which such commercial considerations may break down the good repute of the specialties concerned. The American College of Surgeons adopted an oath to be taken by its fellows to the effect that they would not participate in the secret division of fees. The Principles of Ethics of the American Medical Association have declared the unethical character of such divisions—direct or indirect.

Now the development of greater complexity in medical practice and in medical relationships has introduced new factors into this problem of barter and trade. The development of roentgenology as an important medical specialty and the establishment of clinical pathologic laboratories to which physicians send patients for the making of highly technical and often costly tests have introduced new sources of rebates, kickbacks and commissions. In some communities means have been proposed for evading the condemnation of medical organizations and societies through the establishment of corporations, cooperative laboratories and roentgenologic offices of multiple ownership.

As might have been anticipated, the ultimate development was recognition by governmental agencies of the fact that the unprotected public was being exploited by such methods. The first warning and one of tremendous significance was

the indictment by the Department of Justice of two manufacturing optical agencies and of a considerable number of ophthalmologists who participated in a plan which took hundreds of thousands of dollars from unknowing patients. A full report appeared in The Journal of the American Medical Association when the Department of Justice took this action during 1946. A popular periodical with millions of circulation has called on the medical profession to cleanse itself as it has repeatedly cleaned its own house in the past. The House of Delegates asked the Secretary of the American Medical Association to call the situation to the attention of every state and county medical society in the nation and to urge on these societies the initiation of the necessary steps toward ridding medical practice of these parasites. The Better Business Bureaus in several large communities, notably Los Angeles, have begun a campaign of enlightenment of the public regarding the extent to which these abuses prevail in their communities; they too have called on the medical profession to take the necessary steps to stop this pernicious practice.

The housecleaning has been too long delayed. Biology has proved that any living organism that tries to maintain itself in the presence of filth invariably dies. The Board of Trustees of the American Medical Association therefore calls on leaders of the medical profession in every community in which the Association is represented to act promptly, remembering, however, the necessity for proceeding in due form by the filing of formal charges against physicians known to be participat-

ing in such methods, thus offering an opportunity for the presentation of evidence and a suitable hearing so that the innocent may not be harmed but the guilty may be properly exposed and punished.

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